

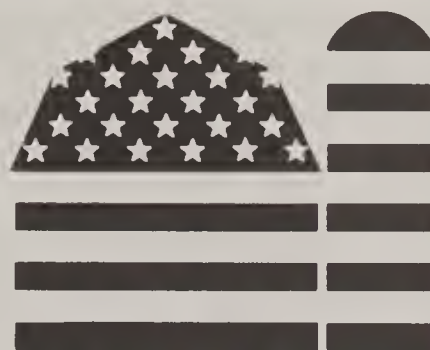
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FARMERS' NEWSLETTER

Cotton



July 81/C-18

The prospect of a much larger crop this year is probably the chief reason for recent declines in U.S. cotton prices, particularly the December 1981 (new crop) contract. And, no doubt, prices for the new crop contracts will be strongly related to growing conditions during the remainder of the summer. As you know, production prospects can turn around on short notice and hardly a summer passes without a few weather scares to generate temporary runups in price.

Since supplies are unusually tight, weather-related price fluctuations could be more intense this summer, particularly during stretches of bad weather. So, watch for these price upswings to fix the price on some of your new-crop cotton or sell your remaining old crop.

Here's some information to help you assess the cotton price outlook and develop a marketing strategy for the coming season--

U.S. Cotton Supplies To Stay Tight

While all signs point to a sharp increase in U.S. cotton production this year, supplies will remain tight. That's because carryover stocks are expected to total only 2.5 million bales when the current season ends on July 31. This would be the smallest carryover in 30 years.

So, if the midpoint, 13.8 million bales, of our early-season production forecast is realized, total supplies for 1981/82 would be around 16.3 million bales.

This compares with 14.2 million this season and 18.6 million the year before.

Keep in mind, however, that final production could differ greatly from that midpoint. We think the odds are about 2 out of 3 that the 1981 crop will range from 12.3 to 15.3 million bales. Although this range is wide, it reflects the recent ups and downs in cotton yields and illustrates why you should keep a close eye on growing conditions across the cotton belt this summer.

As the chart on page 2 indicates, changes in average yields have accounted for most of the wide swings in production in recent years. More than likely, the pattern will hold again in 1981. So far, growing conditions point to yields averaging far above last year's abnormally low 404 pounds per harvested acre.

Demand Prospects Brighten

Exports and domestic mill use of U.S. cotton are expected to rise with next season's increase in supply. Total use during the new year starting in August could be around 12.8 million bales, up from this season's estimated 11.8 million.

Exports may be about 12 percent larger next next season with about 6.7 million

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Principal contributor to this issue:
R. Samuel Evans (202) 447-8444

The next cotton newsletter is scheduled for early September.

COTTON SUPPLIES
LIKELY TO STAY TIGHT

| Crop year beginning August 1 | 1979 | 1980 ¹ | 1981 ² Pro- jected | Fin- ish, variab. |
|--------------------------------------|------|-------------------|-------------------------------------|----------------------|
| Million 480-lb. bales | | | | |
| Beginning stocks | 4.0 | 3.0 | 2.5 | ±0.2 |
| Production | 14.6 | 11.1 | 13.8 | ±1.5 |
| Total supply ³ | 18.6 | 14.2 | 16.3 | ±1.5 |
| Mill use | 6.5 | 5.8 | 6.1 | ±0.5 |
| Exports | 9.2 | 6.0 | 6.7 | ±1.5 |
| Total use | 15.7 | 11.8 | 12.8 | ±1.7 |
| Ending stocks ⁴ | 3.0 | 2.5 | 3.6 | ±1.1 |
| Cents per pound | | | | |
| Farm price | 63.4 | ⁵ 76.4 | (⁶) | |
| Loan rate ⁷ | 50.2 | 48.0 | 52.46 | |

¹ Estimated. ² As of July 13, 1981. Chances are two out of three that the outcome will fall within the implied ranges. ³ Includes imports. ⁴ May not add because of rounding. ⁵ Average to April 1, 1981. ⁶ USDA is prohibited from publishing cotton price projections. ⁷ For SLM 1-1/16" cotton.

bales likely to be shipped, compared with this season's estimated 6.0 million. Our exports should get a boost from the relatively low carryover anticipated in foreign countries this summer and prospects for increased foreign mill use next season.

In contrast, U.S. mill use may increase modestly next season--to about 6.1 million bales. While cotton prices are becoming more competitive with polyester staple, general economic conditions will largely dictate how much cotton manufacturers will buy. Current prospects suggest little improvement from this season.

Another factor that could limit mill use is our widening trade deficit in cotton textiles. During the first 4 months of 1981, the cotton content of our textile imports equaled 640,000 bales of raw cotton. Meantime, our textile exports represented only 290,000 bales, leaving a deficit of 350,000. In contrast, the deficit for the first 4 months of 1980 was only 146,000 bales.

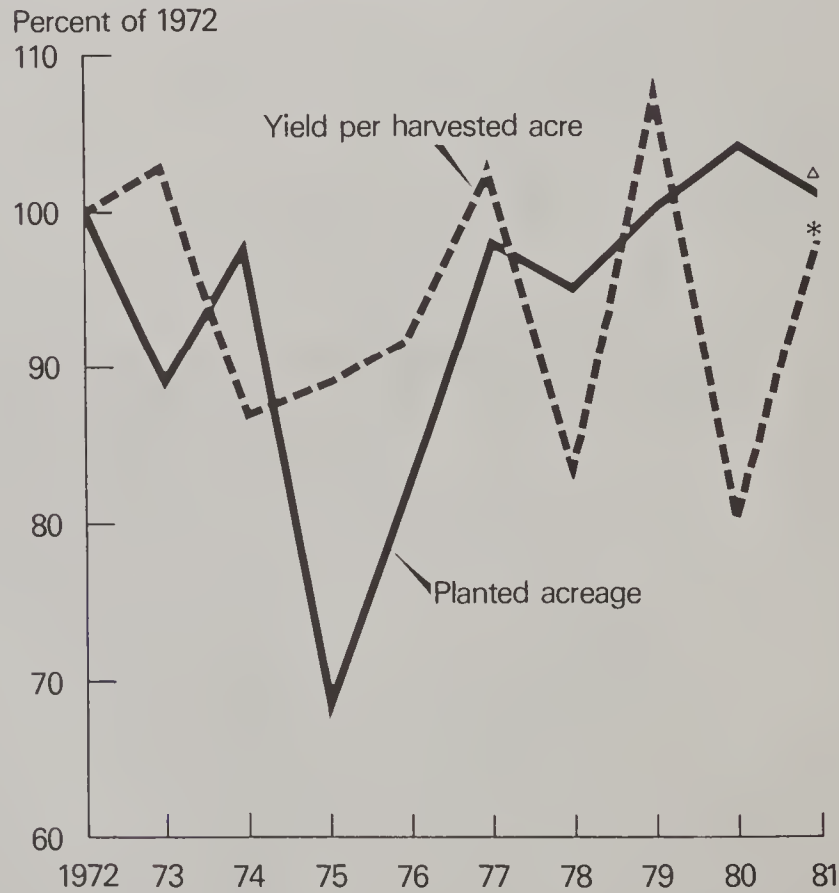
Stocks and Prices

Early forecasts of cotton production and use point to a moderate increase in U.S. stocks next season. Stocks on August 1, 1982, could be around 3.6 million bales, up from this summer's estimated 2.5 million. But, considering the uncertainties for next season's outlook, we think chances are 2 out of 3 that ending stocks will be in the range of 2.5 to 4.7 million bales.

This wide range suggests a potential for cotton prices to vary sharply from this season's average levels. The ratio of ending stocks to disappearance has traditionally been a good indicator of changes in average upland cotton prices from year to year.

For example, for 1977/78, the ratio of ending stocks to disappearance was about 44 percent, and SLM 1-1/16" cotton averaged 53 cents a pound. With a short crop the following year, the ratio dropped to 31 percent--and the average price rose to 62 cents a pound.

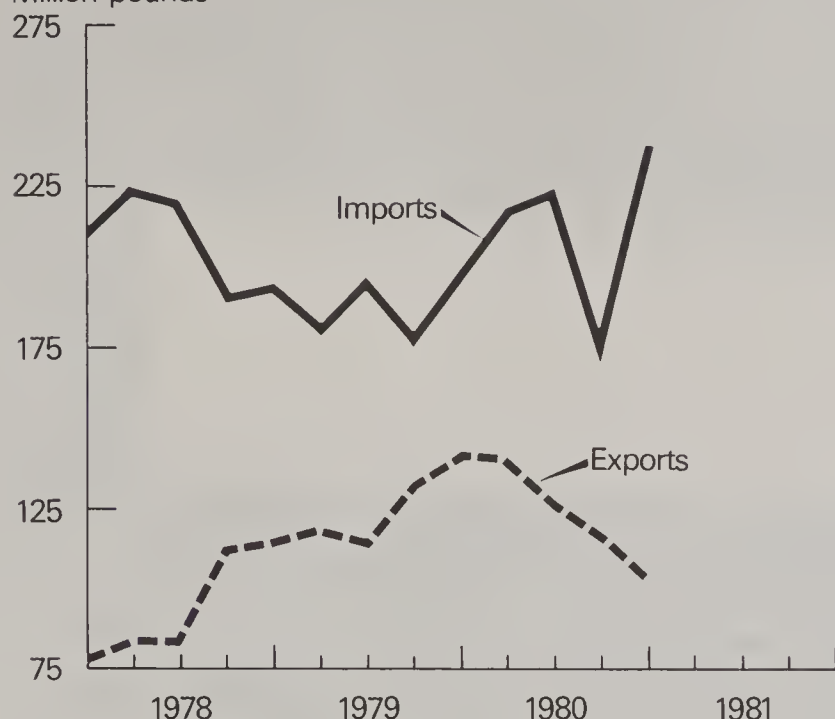
ACREAGE STABLE, BUT YIELDS VARIED
WIDELY IN PAST 4 YEARS



*Yield projected as of June 30, 1981.
^Δ Acreage based on June 1 survey.

COTTON TEXTILE TRADE DEFICIT WIDENS

Million pounds



Supplies tightened further in 1979/80 with the ratio falling to 19 percent and average prices climbing to 71 cents a pound.

The ratio may rise slightly to around 21 percent for 1980/81. Fueled by a strong speculative element last winter, however, spot market prices for SLM 1-1/16" cotton have averaged around 84 cents a pound so far this season. By the end of June, the spot market price had fallen to 77 cents a pound.

Ending stocks could increase to around 28 percent of disappearance next season if cotton production is near the midpoint of our forecast range.

However, the wide ranges on the production and disappearance forecasts imply similarly wide ranges on the ratio of stocks to disappearance and, therefore, on average price.

To protect against such price uncertainty, cotton producers often forward contract some portion of their expected production. By the end of June, producers had forward contracted only about 6 percent of upland acreage, compared with from 14 to 42 percent at the same time during the past five seasons. This year's smaller percentage reflects falling cotton prices in recent months.

Seasonal Price Movements Also Important

While an analysis of market fundamentals helps gauge the direction of changes in season-average prices, price movements during the season are just as important--and perhaps more important--to farmers. The table below shows when monthly average prices for SLM 1-1/16" cotton in designated spot markets hit highs and lows. (Data for 1980 run only through June.)

The high price is marked by an "H" and the low by an "L." The difference between the two appears in the right-hand column. These differences, ranging from 7.6 to 30.3 cents a pound, reveal the importance of timing your cotton sales.

MONTHLY HIGH AND LOW COTTON PRICES

| Year | Aug | Sept | Oct | Nov | Dec | Jan | Feb | Mar | Apr | May | Jun | Jul | Range of Prices c/lb. |
|--------|-----|------|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----------------------|
| 1971 | L | | | | | | | | | H | | | 10.5 |
| 1972 | | | L | | | | | | | | | H | 26.4 |
| 1973 | | H | | | | | | | | | L | | 25.3 |
| 1974 | H | | | | | L | | | | | | | 14.3 |
| 1975 | L | | | | | | | | | | | H | 30.3 |
| 1976 | | | H | | | | | | | | | L | 18.7 |
| 1977 | | | | L | | | | | | H | | | 9.6 |
| 1978 | | | | H | | | | | L | | | | 7.6 |
| 1979 | | L | | | | | H | | | | | | 18.5 |
| 1980 | | | | | H | | | | | | L | | 9.3 |
| Totals | | | | | | | | | | | | | |
| Highs | 1 | 1 | 1 | 1 | 1 | 0 | 1 | 0 | 0 | 2 | 0 | 2 | |
| Lows | 2 | 1 | 1 | 1 | 0 | 1 | 0 | 0 | 1 | 0 | 2 | 1 | |

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But the distribution of the monthly highs and lows for the season--shown at the bottom of the table--indicates there is no magic formula for deciding in advance when to sell your cotton. For example, during the peak harvest period--August through December--there were 5 monthly highs and 5 monthly lows during the 10-year period. Bear in mind that harvesting is generally considered a time when prices hit seasonal lows.

During the last 3 months of the crop year--usually considered a time of seasonally high prices--there were 4 monthly highs and 3 monthly lows.

If you decide to delay sales of your new-crop cotton or what is left of the 1980 crop, keep in mind that the cost of holding it varies with interest rates. In fact, high interest rates have been cited as a primary reason for the recent general decline in commodity prices.

Farmers and other investors must weigh the likelihood of commodity price increases against the costs involved and the potential returns from other investments, such as the money market.

The following example shows how you can calculate the monthly cost of

storing cotton--using the Commodity Credit Corporation (CCC) loan program:

Suppose you could sell your cotton for 80 cents a pound or put it under loan for 53 cents. The CCC interest rate is now 14-1/2 percent and will be adjusted on October 1 and April 1.

1) Calculate the monthly return you forfeit by putting cotton under loan rather than selling it for 80 cents a pound. Let's assume a money market interest rate of 16 percent:

$$\frac{0.16}{12} \times (80¢ - 53¢) = 0.36¢/\text{lb.}$$

2) Figure the monthly interest on the CCC loan:

$$\frac{.145}{12} \times 53¢ = 0.64¢/\text{lb.}$$

3) Add insured storage costs per month. Let's assume it's 0.3¢ lb. The monthly cost of storage is therefore

$$(.36¢ + .64¢ + .3¢) = 1.3¢/\text{lb.}$$

In this example, prices would have to increase by 1.3¢ a pound per month, or 13¢ over the 10-month CCC loan period, to cover storage and interest costs.

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